BEFORE THE DEPARTMENT OF JUSTICE
FOR THE STATE OF MONTANA

In the Matter of the Application for a Certificate of Public advantage by the Columbus Hospital and the Montana Deaconess Medical Center, Great Falls, Montana	)))))	Benefis Healthcare Petition for Modification of the Certificate of Public Advantage

Submitted December 6, 2002

I. INTRODUCTION

The Montana Department of Justice approved the consolidation of Montana Deaconess Medical Center and Columbus Hospital in 1996, subject to certain important terms and conditions set forth in a Certificate of Public Advantage (the "COPA") granted to the hospitals by the Department. After this, the two hospitals completed their consolidation and the new entity, now known as Benefis Healthcare, has followed the terms of the COPA ever since.

The COPA created an intricate regulatory framework in which Benefis operates. The principal financial restraint in the COPA set a cap on the revenues Benefis could earn from both patient services and non-patient activities. This revenue cap was designed to ensure that Benefis would make good on the promise of the consolidation: to operate more efficiently as one hospital instead of two, to achieve millions of dollars in savings, and to pass these savings on to the community. When the COPA was designed, the Department of Justice recognized that if Benefis were able to achieve the targeted cost savings the hospital should be permitted to earn a reasonable margin on its revenues, set at six percent. With an appropriate margin a hospital can invest in the health of the community by providing new technology, needed services, and expanding where necessary. In fact, the COPA provided that if Benefis could save more than the targeted cost savings, it could earn more than a six percent margin.

In important ways the COPA has been a tremendous success for Benefis, the Department of Justice, the people of Great Falls, and the State of Montana. In the years since the COPA was implemented Benefis has saved more than the targeted amounts. In the process, Benefis has moved from a high cost hospital to one of the most efficient and low cost hospitals in the State. Prices at the hospital are down 12 percent since the formation of Benefis.

Despite this success, Benefis has not earned the intended margin of six percent. In fact, the hospital has earned a far smaller margin over the years since the consolidation. So far this year (through September 2002) the hospital's net income margin is at the break-even point. If Benefis is to continue to deliver quality health care to the community the COPA must be adjusted to permit the hospital to earn an appropriate margin. Accordingly, Benefis is submitting

this petition to modify the COPA to accomplish this goal. By adopting the modifications proposed below (*see* Section II.A.), the Department of Justice can maintain the benefits delivered by the COPA, of efficient and effective health care for the people of north central Montana, while ensuring the hospital has the financial resources to provide quality care in the future.

This petition also addresses a second, unintended effect of the COPA. All revenues, not just patient revenues, are included under the revenue cap. The inclusion of investment income creates an unexpected incentive for the hospital to spend reserves, even when borrowing is cheaper. As explained below (*see* Section II.B.), the problem can be addressed easily by excluding non-operating income from the revenue cap.

Finally, there are several non-financial restrictions imposed by the COPA which, after the benefit of six years' experience, Benefis seeks to modify to permit more efficient administration of the COPA. These changes will position Benefis to respond to the changing competitive environment, while preserving the public benefits delivered by the COPA. (*See* Section III.)

II. RELIEF REQUESTED TO THE COPA REVENUE CAP

The COPA permits Benefis to request modifications to terms and conditions that Benefis believes "are justified by unforeseen circumstances [and] changed conditions in the marketplace," among other reasons. COPA ¶ 17.2. Requests that are necessary to improve access or "provide sufficient funding to the Hospital to ensure quality health care" will be granted by the Department.

A. The COPA Should Be Modified to Increase the Inflation Factor in the Existing Revenue Cap Formula.

1. The Methodology of the COPA's Revenue Cap.

The COPA includes provisions that deal directly with the hospital's revenues and costs and other non-cost provisions that deal, at least in part, with quality issues. The central feature of the cost provisions is the cap imposed by the COPA on revenue collected by Benefis. To understand the problems Benefis has encountered with the revenue cap it is important first to review how the revenue cap works.

The model begins by requiring the calculation of a baseline cost figure. This represents the actual costs for the two hospitals preceding the consolidation, reduced by the savings that were projected to flow from the consolidation. Thereafter, on an annual basis, various adjustments are made to this cost figure to account for factors such as changed patient volume, inflation, and changes in aggregate patient acuity. These adjustments result in a "total cost target" for the year in question. A margin of six percent is then added to the total cost target to produce a total revenue cap. Nonpatient revenues (interest income, for example) are deducted and the result is a figure known as the patient revenue cap.

The patient revenue cap is compared to Benefis's actual patient revenues. The COPA provides that any excess of actual revenues over the revenue cap must be returned to consumers through lower prices in future years. If the excess exceeds a specified amount the Department will ensure that the excess is applied to benefit the people of Montana.

Thus the intent of the revenue cap model was to establish controls on Benefis's net revenues, thereby indirectly controlling price increases and operating expenses. The model did not include a control on net income, and no such control was intended. The model was designed to give Benefis an incentive to achieve greater cost reductions than those targeted by allowing the margin to exceed six percent if such savings were achieved.

2. The Success of the COPA.

a. Benefis Has Exceeded the Targeted Cost Savings and Has Passed These Savings on to the Community.

Benefis has exceeded the targeted cost reductions required by the revenue cap contained in the COPA. Over the five-year period from 1997 through 2001, Benefis achieved $8.4 million more in savings than required by the aggregate target amounts. *See* Attachment A (outlining the required target cost reductions and comparing these to the cost reductions actually achieved).

b. Benefis's Prices Have Dropped Since the Merger.

Before the merger, prices at Benefis's predecessor hospitals were among the highest in Montana. Today, however, because Benefis delivered on the cost savings promised at the time

of consolidation, the hospital is positioned as one of the most efficient, low cost hospitals in the state. Benefis offers prices for its services that are substantially lower than those charged by similar hospitals in Montana. In fact, since the merger, there has been a 12.1 percent drop in overall prices at Benefis (reflecting years 1996-2001). *See* Attachment B.

When average patient charges (gross patient revenue per discharge) are compared within Montana, Benefis's charges are, on average, 33 percent less than the charges of the other hospitals in its peer group. *See* Attachment C. On a net revenue per discharge basis, Benefis's charges are nine percent lower than those of its peer group. This represents a tremendous savings for the people of Montana: If Benefis's charges (on a net revenue basis) were the same as those of its peer group, in fiscal year 2001, Benefis's actual net revenues would have been $13 million higher than they were.[1]

Moreover, Montana's hospitals, as a group, are among the lowest cost hospitals in the United States. In 2000, Montana hospitals had an average cost per discharge that was seven percent below the national average. (This can be derived from Attachment D.) Montana also does well when compared to the other states in the northwest: our state's average cost per discharge is lower than the average cost for the hospitals in these states. *See* Attachment D. Similarly, prices in Montana are lower than the national average and lower than in all the states in the northwest. *See* Attachment E.

Thus, Benefis is one of the lowest cost hospitals in a state whose hospitals, taken as a whole, have costs below the national average.

c. Benefis Continues to Exercise Responsible Cost Control.

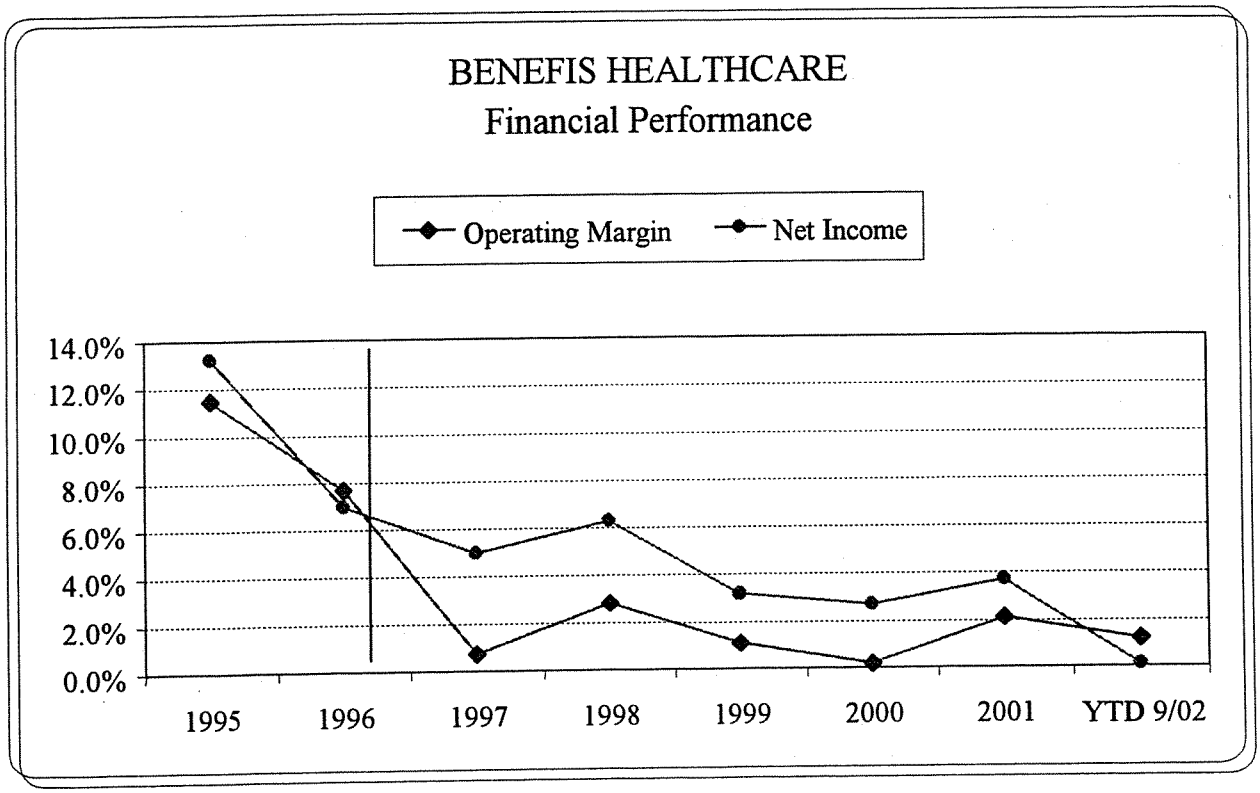
Benefis has done very well in controlling its costs on an ongoing basis and moderating hospital cost increases. Through fiscal year 2001, the average annual cost per adjusted discharge at Benefis grew just 1.5%. *See* Attachment F. This compares to a 3% inflation factor in the

[1] The Benefis average net revenue per discharge is nine percent below its Montana peer hospitals. When applied to the fiscal year 2001 actual net revenues ($153,000,000), the additional net revenue would be $13.8 million.

market basket index prepared by the federal government (the "MBI") over the same period of time.

3. The Unexpected Problem: Benefis is Not Earning the Margin Intended Under the COPA.

Under the revenue cap model, Benefis was to earn a six percent return if it achieved the targeted cost reductions. In fact, as Benefis exceeded these cost savings, under the model the hospital should have been able to achieve more than a 6 percent margin. A rough calculation would indicate that Benefis should be enjoying net income of approximately 13-14 percent as a result of holding its average cost increases to 1.5 percent.[2] In reality, Benefis has earned far less than a six percent margin, as the table and graph set forth below show:



[2] This is calculated by taking the 3% MBI, deducting Benefis's 1.5% average cost increase, and multiplying the difference by the five years between 1997 and 2001, to produce an incremental margin of 7.5%. When this is added to the 6% original margin, the result is a margin of 13.5%.

Year	Operating Margin Dollars	%	Net Income Dollars %	
1995*	$15,023,025	11.5%	$17,163,000	13.2%
1996	$11,250,760	7.7%	$10,288,975	7.0%
1997	$934,864	0.7%	$6,969,638	5.0%
1998	$3,912,995	2.8%	$9,065,209	6.3%
1999	$1,610,915	1.1%	$4,381,269	3.2%
2000	$264,130	0.2%	$3,947,466	2.7%
2001	$3,194,479	2.1%	$5,752,018	3.7%
YTD 9/02	$1,484,327	1.2%	$138,504,	0.1%

* MDMC 6/30/95
Columbus 12/31/95

The graph and table show that the situation is worsening. Benefis's operating margin has fallen from a pre-merger level of 11.5 percent in 1995, to 2.1 percent for fiscal year 2001, and is just 1.2 percent through September 2002. A similar deterioration is reflected in the net income margin which stood at 13.2 percent in 1995, before the merger, but which declined to 3.7 percent for fiscal year 2001, and currently stands at 0.1 percent through September 2002.

These figures demonstrate the problem that confronts Benefis. The revenue cap model imposed by the COPA contemplated that if Benefis could achieve the targeted cost savings it would earn a margin of 6 percent. If it exceeded these cost savings the hospital was to earn an even greater margin. Benefis has exceeded the targeted cost savings required by the COPA, yet the hospital consistently has realized a margin below, and sometimes well below, the targeted six percent margin. Today the margin is barely positive.

A hospital cannot operate on such razor-thin margins for very long and provide quality health care, as the cash generated from operations is the financial lifeblood of the hospital. In a typical year, Benefis must generate $7-8 million from operating income to pay for necessary expenditures, including capital expenditures and "seed money" to be invested in clinical

programs and services. Yet, as noted above, Benefis has been generating operating income margins of only $1-3 million over the last several years. This falls far short of the amount the hospital needs to serve the community. Because Benefis is dedicated to providing high quality health care services, it has drawn down its reserves to fund the shortfall from operating margin cash. *See* Attachment G. Needless to say, drawing down the reserves cannot continue forever.

If Benefis is to maintain quality services and financial viability it must achieve a margin of at least five to six percent. Since Benefis is a not-for-profit organization, its net income does not benefit private individuals. Instead, this revenue is used to enhance and expand hospital services for the residents in the hospital's service area. Thus, the people who ultimately will benefit from an improvement in the margin will be the residents of north central Montana.

4. Possible Explanations for the Problem.

a. Additional Competition Has Caused Benefis to Earn Less, Even Though the Hospital Exceeded the Targeted Cost Savings.

The fact that Benefis has exceeded the targeted cost savings, while simultaneously failing to achieve a 6 percent margin, suggests an unanticipated anomaly in the revenue cap model. We believe that this incongruous result comes about, at least in part, because the model assumes that all revenue sources contribute equally to profitability, that is, the model implicitly assumes the cost/revenue relationship is the same for all services at Benefis. The reality is different, however. Each service at Benefis has a different level of profitability, as a result of differences in the cost/revenue relationships.

Since the merger, competitors have opened in Great Falls or have dramatically expanded the scope of their services. The most prominent competitors are the Central Montana Surgery Center and the Great Falls Clinic Surgery Center. The hospital has lost a great deal of patient volume to these competitors. For example, since 1999, the volume of outpatient surgeries at Benefis has dropped by approximately two-thirds. After the installation of a CAT scan (in 1997) and an MRI (in 2000) at the Clinic, the number of scans performed at the hospital also fell off. The Central Montana Surgery Center recently added its own CAT scan and is in the process of

installing an MRI. Additionally, since the date of the merger, the Clinic began providing lithotripsy services (through an outside vendor). This has resulted in a loss of a great deal of the hospital's business in this area. The examples of competition that have sprung up since the date of the merger could be multiplied, but probably the most significant competitive development has yet to occur – the Central Montana Surgery Center has transitioned into a surgical hospital, which opened in November 2002. Benefis anticipates further losses of volume as a result.

Not surprisingly, these competitors have focused their competitive energies on those services with the lowest cost/revenue ratios (that is, the services that produce the highest profit). As the hospital has lost business to these competitors, the average profitability associated with a dollar of revenue has declined. Stated differently, as the hospital has lost services that cost the least to provide, the average cost to generate a dollar of net revenue has increased. As a result, the hospital's costs today are higher than the cost base used by the COPA's revenue cap model, even after adjustments are made to that base to account for inflation, patient volume, and changes in aggregate patient acuity.

This is confirmed by the table set forth in Attachment H. The Table shows that in 1997, the hospital's actual costs were $4.8 million higher than the costs predicted by the COPA revenue cap model. In 1998-2001, the hospital's actual costs were between $7.1 million and $8.5 million higher. This year, actual costs are expected to exceed COPA costs by over $13 million.

Benefis's permitted revenues, however, are figured by adding a margin to the costs predicted by the COPA revenue cap model. As these costs no longer reflect reality – they are far short of it – this means that adding a six percent margin to the hypothetical COPA cost number does not provide Benefis with a six percent margin over its real costs. Moreover, as the gap between the hospital's actual costs and "COPA costs" continues to grow, Benefis's margin will continue to shrink and soon could become negative.

The revenue cap model assumes that if Benefis achieved the targeted cost savings following the consolidation the hospital's actual costs would be the same as its "COPA costs" –

those used as the benchmark in the revenue cap calculation. Yet, though Benefis has exceeded the targeted cost savings by more than $8 million, the hospital now is struggling to maintain a positive margin.

b. The MBI Inflation Factor Does not Reflect the Actual Rate of Increase in Benefis's Costs.

Although Benefis has worked diligently to achieve the required cost reductions outlined in the COPA, the items affected by those reductions represent only a fraction of the hospital's total operating expenses. Over the past several years many of Benefis's costs have increased dramatically. Reflecting on these large cost increases raises the question of how accurately the MBI inflation index for hospitals reflects cost inflation increases at Benefis. Set forth below are a number of examples of significant cost increases incurred by Benefis over the last few years which have greatly exceeded the MBI inflation factor, which has averaged approximately three percent per year. In addition to representing large percentage increases, the items below also represent large dollar amounts, which in their aggregate would seem to make a three percent overall inflation level inappropriately low.

- Employee Wage Inflation (as represented by pay raises). Over the past three years (FY 2000-2002), Benefis has averaged pay raises of 5.5%, and is budgeting for a 5% aggregate pay raise in FY 2003. As the shortage of nurses and other clinical staff worsens, wage rates will continue to increase at an escalating pace. Given that wages constitute over half the hospital's operating expenses, and they are increasing at 5.5% annually, the aggregate increase of all other expenses would have to be 0.5% per year (or less) in order to achieve an overall average of 3% as reflected in the MBI. This is not the case, however. Benefis's other expenses are increasing at an inflation noticeably higher than 0.5%.

- Employee Health Insurance. Like virtually all other employers, Benefis has been experiencing significant increases in its employee health insurance premiums. Over the past three years (FY 2000-2002) premium expense has increased an average of 23% per year, representing a cost increase of more than $1 million per year. This growth trend shows little sign of slowing, as the premium increase for FY 2003 is budgeted at 10.6%.

- Utilities. Utility costs have increased dramatically over the past few years. The aggregate increase between FY 1999 and FY 2002 was 48%, which represents an average of 16% per year. In monetary terms, this represents an average annual increase of more than $200,000 per year.

- Workers' Compensation Costs. Workers' compensation costs also have been rising significantly over the past several years. The aggregate growth between FY

1999 and 2002 was 93%, which equals an annual average growth of 31%, representing an annual increase in cost of more than $400,000.

- Clinical Supplies. Focusing on clinical supplies in the areas of pharmacy, cardiovascular services, clinical warehouse supplies, and blood products, aggregate costs have risen from $17 million in 1999 to $24 million in 2002. This is an aggregate growth of $7 million, or $2.3 million per year. This represents an annual inflation growth of 13.8%.

- Property and Liability Insurance. Insurance coverage for Benefis also has risen dramatically over this three-year time period, with premiums growing from $327,000 up to $880,000, representing an average annual growth of $184,000, and representing a 56% average annual increase.

5. The Requested Relief: Increase the Inflation Factor in the Existing Revenue Cap Formula.

a. A Brief History of Discussions and Proposals 2001-2002.

Benefis approached the Montana Department of Justice with its concerns in the summer of 2001. Since then Benefis has discussed a number of possible modifications to the COPA revenue cap with the Attorney General's staff and consultants.

- Initially Benefis discussed the possibility of eliminating the COPA and revenue cap in its entirety. The Department of Justice made it very clear it would oppose such a proposal.

- Benefis then discussed a "peer group model" that would shift the focus of the revenue cap from a historic cost basis to a peer group revenue basis and use other Montana hospitals to create a competitive benchmark. Benefis proposed that it be permitted to earn, on a case mix adjusted, revenue per discharge basis, an amount comparable to its peers in Montana. Over the months in which informal discussions were had regarding this model it became clear to Benefis that the Department of Justice and its consultants were concerned that the data needed to make a peer group model work may not be available over the long term and that the peer group's performance might not be the optimal benchmark.

- Benefis then discussed other possibilities, such as a major change to the current revenue cap model in which costs on which the revenue cap is determined would be rebased, or inflating the hospital's case mix adjusted revenue per discharge by an agreed inflation factor. Ultimately, a mixture of the complexity of the issues involved in these discussions and additional concerns that were raised about the proposals led Benefis to conclude that a simpler solution was needed.

b. Benefis's Proposal.

Benefis now proposes a simple change that should result in an adequate relief for Benefis to achieve and maintain financial health and viability, and which is straightforward to implement and administer. Benefis proposes, for a four-year period of time (calendar years 2002-2005), to

increase the inflation factor by an additional one percent each year over the MBI amount. Thus, in the first year, the add on will be one percent, in the second year it will be two percent, in the third year it will be three percent, and in the fourth year four percent.[3] While phasing in the increase sought by the hospital means that Benefis must wait four years to realize the full benefit of the proposal, this will have the important effect of ameliorating any effect on payers by allowing them to absorb the change slowly.

B. The COPA Should Be Modified to Exclude Non-Operating Income from the Revenue Cap.

1. The Effect of the Revenue Cap Model on Financing Decisions.

The current revenue cap model creates a disincentive for Benefis to exercise prudent business decisions as relates to financing alternatives. There is an incentive under the model never to incur debt (*i.e.*, loans, bonds, leases, etc.) but rather to draw down on reserve funds. Prudent business decisions would compare the cost of borrowing to the earnings potential of retaining reserves, and where the earnings potential exceeds the cost of borrowing a prudent business person would proceed with borrowing funds.

This is not the case with the COPA revenue cap model. The model requires all income to be subject to the cap, including all investment income. On the other hand, since allowable revenues are indexed to 1995 costs, any additional costs of interest are not adjusted within this base number, and thus must simply be absorbed. As an example, this past summer Benefis participated in a bond offering through Providence Services whereby Benefis obtained $20 million to help finance the construction of a replacement surgical suite. The average interest on these bonds is 2.7 percent, as compared to the investment earnings potential of Benefis's

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[3] Specifically, Benefis recommends that this modification be made to worksheet three of the current revenue cap model, and be achieved by adding a line 18 A titled "Inflation Add-on," and a line 18 B titled "Adjusted Inflation Index." In the first year, the inflation add on would be .01, and the second year the inflation add on would be .02, in the third year the inflation add on would be .03, and in the fourth year the add on would be .04. The second new line, 18 B, would simply be the addition of line 18+ line 18 A. Line 19 would remain as is except the calculation would be line 3 times line 18 B.

portfolio of 6-8 percent. On the surface, it would seem like a prudent business decision to pursue the bond issue. However, without a modification to the COPA, this decision actually will have a negative financial impact on Benefis, as all the investment income is considered revenue under the COPA, while none of the new interest expense is reflected within the allowable revenues.

As a result of this, the financial reserves at Benefis have been progressively depleted. *See* Attachment G. A common measure of financial health for hospitals is the number of days cash on hand. An "AA" rated hospital should have 170-200 days of cash on hand. This reflects the Standard & Poors bond rating medians for non-profit health care institutions in 2001. In 1997, shortly after the merger, Benefis met this standard, with 182 days of cash on hand. *See* Attachment G. As of September 2002, however, this had deteriorated to 100 days of cash on hand.

2. The Requested Relief: Exclude all Non-Operating Income from the Revenue Cap.

Benefis proposes excluding all non-operating income from inclusion under the revenue cap. This represents a one-time enhancement to the allowable revenue, although the modification will carry forward from year to year. Based on the 2001 final revenue cap model, this would exclude $2.7 million of net income from inclusion in the Model.[4]

C. The Financial Effect of the Relief Requested.

Pro forma modeling of the effect of the proposed changes (to include an add on to the MBI inflation factor and to exclude non-operating income from the revenue cap) has been prepared for a four-year period of time (to correspond with the four years over which the inflation increases will gradually be phased in). *See* Attachment I (the attachment presents three different models, using the actual results from fiscal years 2000 and 2001, and projected annual financial results for fiscal year 2002). The proposed changes would add $3.464 million in the first year to Benefis's revenues, and slightly larger amounts in each year thereafter, through the

[4] The proposed modification to the current Revenue Cap Model would be to worksheet seven, and would simply be the elimination of line three, titled "Investment Income (non-operating income)."

fourth year. Because Benefis expects total revenues of $157 million for fiscal year 2002, Benefis would have to increase prices (gross revenue) by only 4.2% in the first year, and under two percent more each of the next years through the four-year period of time, to achieve this result. *See* Attachment J (summarizing the increase in allowable net revenues over four years, using 2000, 2001, and 2002 as base years).

Another way to consider the effect of this proposal is to recall that Benefis's net revenue per patient discharge is approximately nine percent less than that of the other major hospitals in Montana. The combined beneficial effect of the two revenue cap modifications requested would narrow this gap by only about two to three percent in the first year. Over the course of four years the gap would be narrowed by a total of five percent. Thus, while the proposal would reduce the gap between Benefis and its peer hospitals, at the end of four years Benefis's net revenue per patient discharge would still lag its peers by four percent. Thus, the proposal preserves a significant financial benefit for health care consumers in the hospital's service area.

Finally, Benefis proposes that the aggregate effects of these changes be reassessed near the conclusion of the four-year period, so that decisions can be made as to whether to continue the percentage add on to the MBI inflator, whether to modify the add on (by increasing or decreasing it), or whether simply to eliminate the add on altogether.

III. OTHER MODIFICATIONS REQUESTED TO THE COPA.

The COPA contains a variety of requirements and restrictions in addition to the revenue cap. Though the primary relief Benefis seeks is a modification in the revenue cap, Benefis believes that certain other requirements should be modified at this time as well. Listed below is a brief outline of these additional COPA modifications. (The numeric references below are to the sections found in Paragraph X, "Terms and Conditions," starting on page 48 of the COPA.) The requested changes, and the reasons for them, are more fully explained in Attachment K.

- 1.5 (Annual Report). An important part of the COPA is the annual report filed by Benefis. Benefis will continue to file this document. Several components of the annual report were geared specifically to the merger process. Benefis proposes eliminating reporting requirements on these items, as they essentially are complete or obsolete.

- 2. (Quality Reporting). Benefis reports quality information to the Montana Department of Public Health and Human Services ("PHHS"). This reporting should continue. Benefis believes that the value of the information reported would not be diminished if the hospital were to move to annual reporting, and thus Benefis proposes this change. Similarly, the hospital requests that the frequency of the employee and physician surveys be reduced to once every three years. Benefis also seeks the discretion to determine the survey tool for physicians, employees, and patients.

- 5. (Non-exclusivity). Benefis currently is permitted to enter into exclusive contracts with physicians in four specialties. This permits Benefis to assure its patients that there will be full time (and, where necessary, 24/7) coverage at the hospital in these important specialties. The hospital seeks to be able to do the same with all hospital-based specialties so as to ensure the quality of care it provides to the community. Accordingly, Benefis seeks to be able to expand exclusive contracts to all hospital-based physician specialties.

- 8. (Agreements with Surgical Facility Providers). Under the COPA, Benefis was not permitted to enter into joint ventures with physicians to offer surgical facilities without the prior approval of the Department of Justice. Since 1996, however, the health care landscape in Great Falls has changed profoundly. A new hospital is being built, the Great Falls Clinic has opened a surgery center, and other providers with physician partners have emerged. Benefis requests elimination of the COPA restriction so that it may have similar flexibility to structure its services in the manner that will best enable it to meet its mission including, where appropriate, by forming partnerships with physicians.

IV. CONCLUSION.

For the reasons set forth above, Benefis Healthcare respectfully requests that the Department grant the requested modifications to the COPA.

RESPECTFULLY SUBMITTED, this 6th day of December, 2002.

BENEFIS HEALTHCARE

John Goodnow	Dale Schaefer, MD	Donald Hamilton
President and CEO	Chief of Medical Staff	Chairman of the Board

ATTACHMENTS

A. Recap of COPA Expense Reductions

B. History of Hospital Price Increases

C. Benefis Healthcare vs. Montana Peer Group Hospitals (comparison of average patient charges)

D. Inpatient Cost per Discharge

E. Net Price per Inpatient Discharge

F. Average Cost per Adjusted Discharge

G. Financial Reserves

H. COPA Expense Analysis

I. COPA Model Analysis (Proformas – 3)

J. COPA Model Analysis – Recap of Modifications Impact

K. Requested Changes to the COPA – Non Revenue Cap Items

Benefis Healthcare
RECAP OF COPA EXPENSE REDUCTIONS
TARGETS VS. ACTUAL

Year	Total Expense Reduction Target	Actual Savings			Actual over/(under) Target
		Wages	Non-wage	Total	
1997	$1,593,091	$3,196,000	$1,685,418	$4,881,418	$3,288,327
1998	$4,915,240	$517,000	$3,219,855	$3,736,855	($1,178,385)
1999	$5,861,051	$3,424,000	$3,948,835	$7,372,835	$1,511,784
2000	$5,803,447	$2,910,800	$3,936,492	$6,847,292	$1,043,845
2001	$5,999,391	$4,727,200	$5,038,518	$9,765,718	$3,766,327
2002	$6,170,586				
2003	$6,295,570				
2004	$6,417,294				
2005	$6,535,984				
2006	$6,654,481				
2007	$6,731,180				
2008	$6,767,671				
TOTALS					**$8,431,898**
VARIANCE AS % OF TARGET ('97-'01)					**35%**

COPA expense reduction recap

Attachment A

HISTORY OF HOSPITAL PRICE INCREASES
PERCENT

	MD/MC (6/30)	CH (12/31)	BENEFIS (12/31/)	COMBINED (average)	CUMULATIVE POST-MERGER INCR<DECR>
1992	8.0	10.6		9.3	
1993	6.0	9.5		7.8	
1994	4.6	5.9		5.3	
1995	0.0	2.0		1.0	
1996	0.0	0.0*	0.0*	0.0	0.0
1997			(17.0)	(17.0)	<17.0>
1998			2.5	2.5	<14.5>
1999 (A)			<2.2>	<2.2>	<16.7>
2000 (B)			1.3	1.3	<15.4>
2001 (C)			3.3	3.3	<12.1>

* Reflects a 6 month time period.

Note: The cumulative net price increase over the 10 year period is 11% or an average of 1% per year. From the point of merger (1996), the cumulative net price change is a reduction of 12% (over the 6 year post merger timeframe this represents an average price decrease of 2% per year).

(A) Initially no price changes were implemented in 1999, however due to COPA overages, approximately $3.7 million in price decreases were enacted between 9/1/99 and 11/30/99, representing a 2.2% annualized price decrease.

(B) The FY 2000 price increase was budgeted at 4.7% and implemented at 1/1/00. Due to COPA overages, a $5.8 million revenue reduction was implemented 10/1/00, with the net effect of reducing the annual price increase to 1.3%.

(C) The initial price change for FY 2001 was an aggregate reduction of 2%. Based on revenues actually trending under the Revenue Cap ceiling, price increases were implemented during the forth quarter of the year, resulting in a net annual price increase of 3.25%.

Source: Benefis Healthcare Year 2001 Budget (prepared 4-4-02)

Attachment B

BENEFIS HEALTHCARE VS. MONTANA PEER GROUP OF HOSPITALS
Comparison of Average Patient Charges
(4-1-02)

	% Over <Under> Benefis			
	Per Patient Day		Per Discharge	
Hospital Ref.	2000	2001*	2000	2001*
A	52.3%	52.3%	<8.3>%	<4.7>%
B	49.9%	50.6%	9.8%	14.7%
C	67.5%	67.7%	12.5%	27.3%
D	62.4%	53.7%	22.3%	29.5%
E	54.6%	56.2%	0.8%	11.0%
Benefis	0.0%	0.0%	0.0%	0.0%
F	42.7%	46.8%	14.4%	23.1%
G	47.5%	48.0%	21.8%	29.6%
H	32.0%	38.6%	22.9%	36.8%
I	56.9%	58.0%	33.9%	41.4%

*2001 figures include January September data only (4th Quarter not available at this time).

NOTE: Comparisons reflect adjustment for case mix differences.

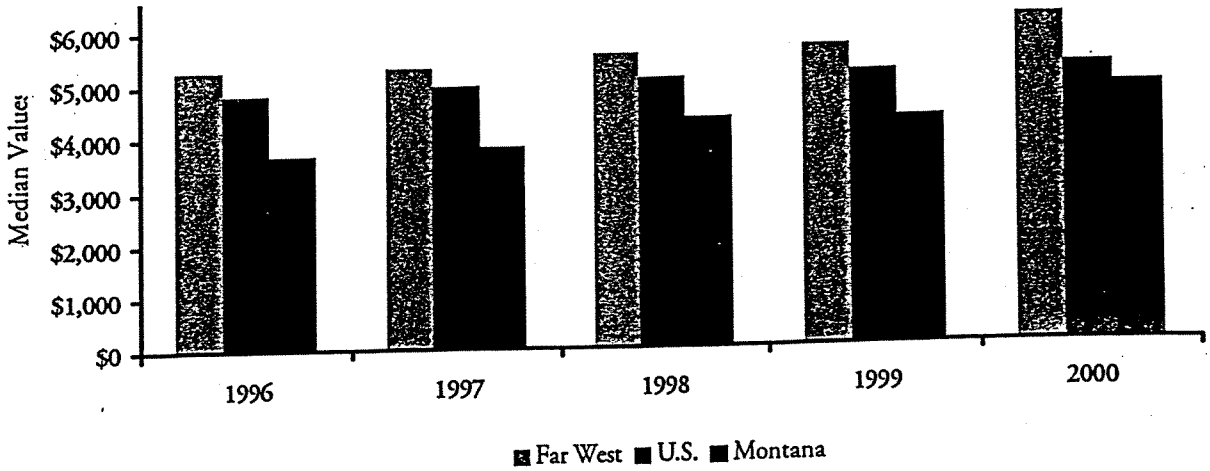
Hospitals A-E are the medium size hospitals in Montana

Hospitals F-I are the large hospitals in Montana. The average percent for this peer group is 33%.

Attachment C

Inpatient Cost per Discharge

Using Medicare Cost Report Indicators



Montana's hospitals rank among the lowest cost providers in the U.S., reflecting lower wage costs and lower average length of stay.

Median Values

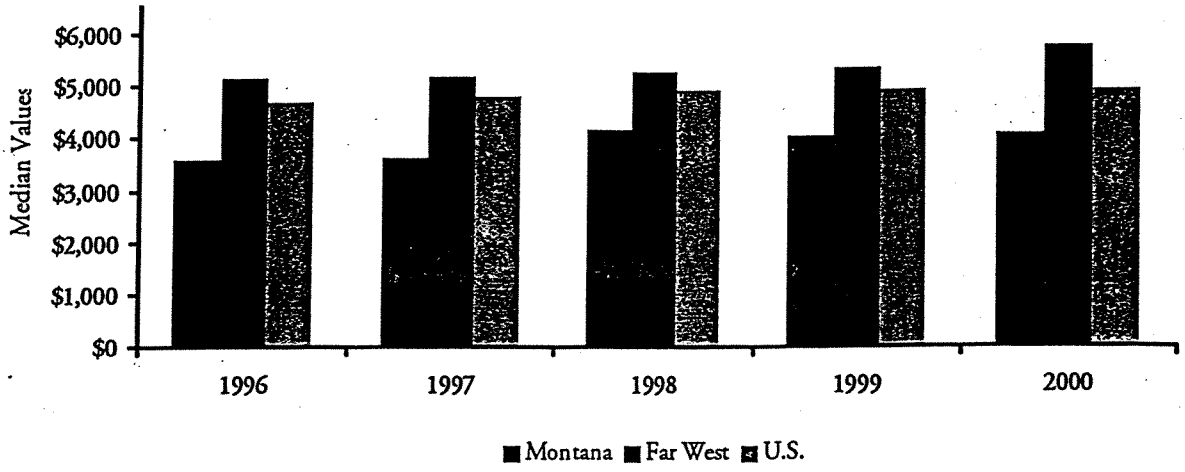
	1996	1997	1998	1999	2000
Montana	$3,671	$3,826	$4,332	$4,286	$4,871
Far West	5,294	5,334	5,550	5,678	6,149
U.S.	4,801	4,955	5,077	5,148	5,255
Idaho	3,940	3,965	4,237	4,314	4,105
Wyoming	4,157	4,354	4,827	4,827	4,907
North Dakota	3,534	3,727	4,349	4,407	4,634
South Dakota	3,541	3,699	3,914	4,063	4,414
Washington	4,309	4,795	4,967	5,101	6,420
Oregon	4,510	4,918	4,903	5,107	5,152

Note: Cost per discharge provides a measure of the total production cost per inpatient discharge. The indicator is not adjusted for case mix or severity differences, but is adjusted for outpatient activity.

Source: Ingenix Almanac of Hospital Financial and Operating Indicators, 2002.

Net Price per Inpatient Discharge

Using Medicare Cost Report Indicators



Using Medicare cost reports, Montana ranks far below the average for the Far West and the U.S. Medicare cost report indicators provide a consistent comparison across state borders. Montana has historically and consistently charged lower amounts for inpatient care on a "per discharge" basis because Montana's hospitals have lower average lengths of stay.

Median Values

	1996	1997	1998	1999	2000
Montana	$3,609	$3,625	$4,169	$4,071	$4,090
Far West	5,148	5,205	5,284	5,372	5,762
U.S.	4,693	4,806	4,921	4,919	4,929
Idaho	3,776	3,989	4,070	4,079	4,206
Wyoming	3,758	4,156	4,601	4,562	4,469
North Dakota	3,563	3,552	4,192	4,412	4,146
South Dakota	3,372	3,592	3,995	4,002	4,369
Washington	4,267	4,700	4,981	4,736	6,042
Oregon	4,499	4,673	4,785	4,768	4,825

Note: Net price per discharge measures the average amount of revenue collected per unadjusted discharge.

Source: Ingenix Almanac of Hospital Financial and Operating Indicators, 2002.

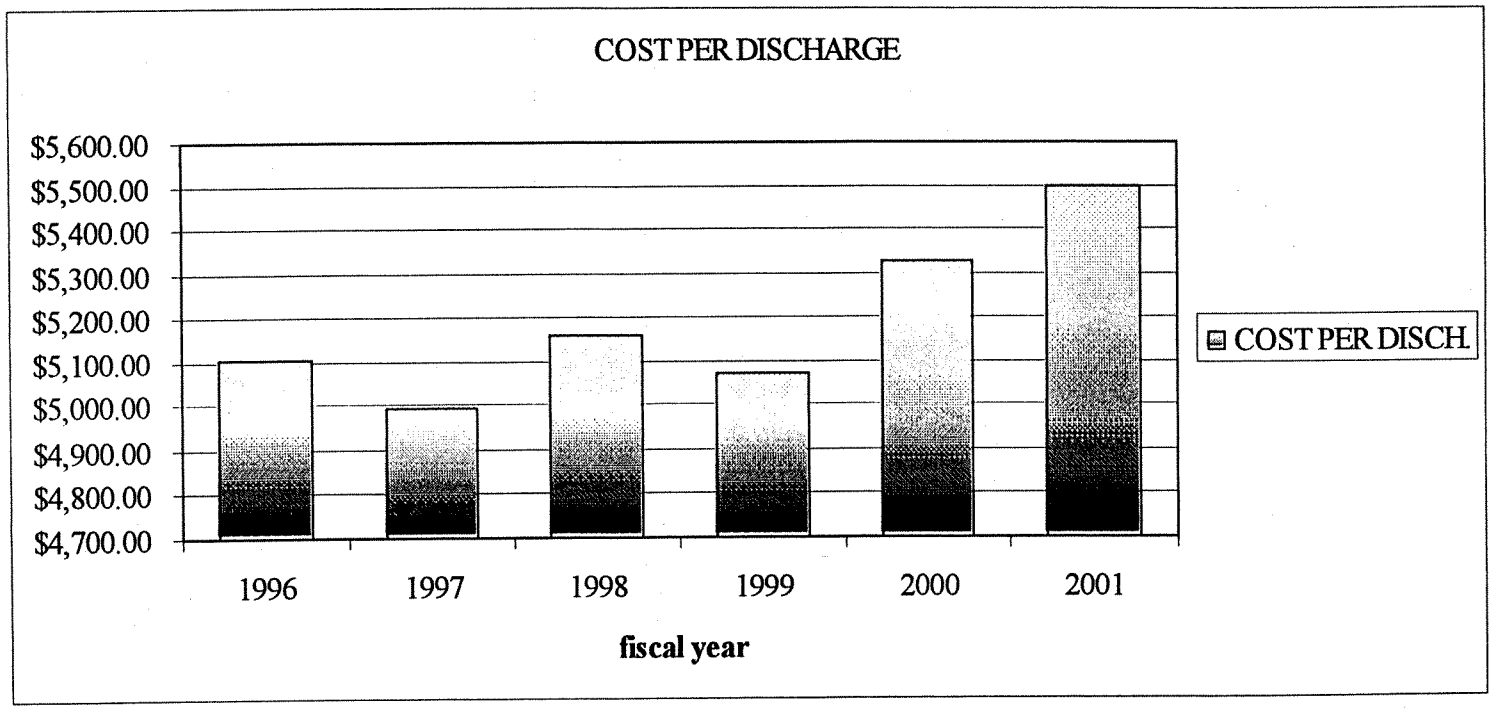
BENEFIS HEALTHCARE

AVERAGE COST PER ADJUSTED DISCHARGE (reflecting CMI)

(prepared 4/1/02)

FISCAL YEAR	COST PER DISCH.	% INCR/DECR ANNUAL	% INCR/DECR CUMULATIVE
1996	$5,104.99		
1997	$4,992.07	-2.2%	-2.2%
1998	$5,160.81	3.4%	1.1%
1999	$5,072.75	-1.7%	-0.6%
2000	$5,327.95	5.0%	4.4%
2001	$5,497.75	3.2%	7.7%

Five Year Annual average = 1.5%



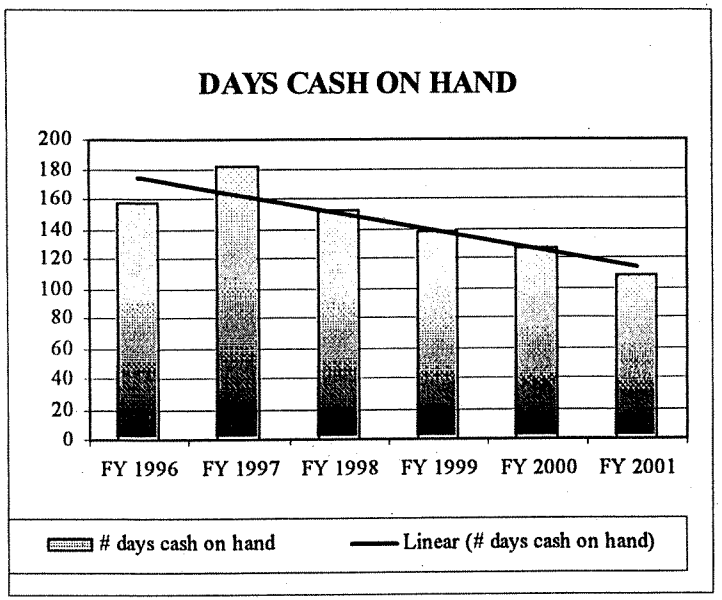
Attachment F

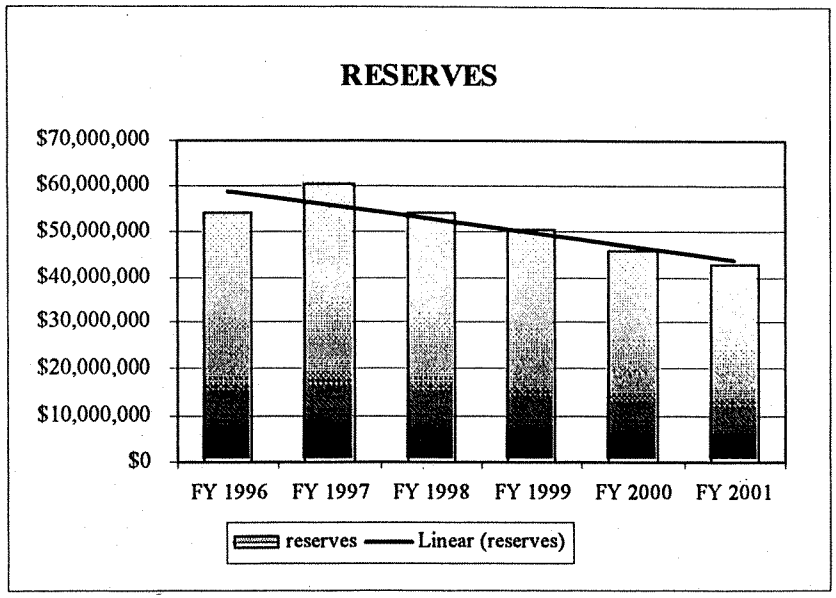
FINANCIAL RESERVES

	FY 1996	FY 1997	FY 1998	FY 1999	FY 2000	FY 2001	Cumulative incr./decr.	FY '01/97 incr./decr.
net income	$10,288,975	$6,969,638	$9,065,209	$4,381,269	$3,947,466	$5,752,018		
# days cash on hand	158	182	152	138	127	108	-32%	-41%
reserves	$53,943,385	$60,549,624	$54,084,373	$50,333,470	$45,646,366	$42,585,191	-21%	-30%

Days cash on hand has decreased 32% since merger, and 41% over the last 4 years.

Reserves have decreased 21% since merger, and 30% over the last 4 years.





Attachment G

Attachment H

COPA Expense Analysis
10/11/2002

	1997	1998	1999	2000	2001	2002*
COPA Expenses						
1995 Baseline Adjusted Operating Expenses	$116,026,775	$116,026,775	$116,026,775	$116,026,775	$116,026,775	$116,026,775
Expense Reduction Target for Year	1,593,091	4,915,240	5,861,051	5,803,447	5,999,390	6,170,586
Allowable Total Costs in 1995 Dollars	114,433,684	111,111,535	110,165,724	110,223,328	110,027,385	109,856,189
Total Cost Target in Current Dollars	126,796,228	125,391,917	127,087,300	133,068,167	141,830,107	144,544,739
Actual BHC Expenses						
Hospital	125,016,497	126,879,023	126,888,542	133,835,372	142,382,873	149,685,210
BSNC	6,586,506	7,045,447	7,307,975	7,518,341	7,810,538	8,064,341
Total BHC Expense	131,603,003	133,924,470	134,196,517	141,353,713	150,193,411	157,749,551
Actual Cost over Target	4,806,775	8,532,553	7,109,217	8,285,546	8,363,304	13,204,812
As % of Target	3.8%	6.8%	5.6%	6.2%	5.9%	9.1%

* Projected using 8-30-2002

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BENEFIS HEALTHCARE
COPA Model Analysis
Year 2002

			Projected 2002	Modified 2002	Modified Year - X	Modified Year - Y	Modified Year - Z
1	Baseline Total Costs	(Worksheet 1, Line 34)	115,025,774	115,025,774	116,026,774	116,025,774	116,025,774
2	Expected Cost Reduction	(Worksheet 12-Year 2003)	5,170,586	5,170,586	5,170,586	5,170,586	5,170,586
3	Allowable Costs in 1995 Dollars	(Line 1 - Line 2)	109,855,188	109,855,188	109,856,188	109,855,188	109,856,188
4	Market Basket Index Est. Current Year-2001	HCFA	134.4600000	134.4600000	134.4600000	134.4600000	134.4600000
5	Market Basket Index Base Year-1995	(Worksheet 3, Line 4)	109.85	109.85	109.85	109.85	109.85
5a	Multiplier	(Line 4/Line5)	1.22	1.22	1.22	1.22	1.22
5b	Add-On			0.010	0.020	0.030	0.040
5c	Revised Multiplier	(Line 5a + Line 5b)	1.22	1.23	1.24	1.25	1.26
6	Allowable Total Costs in Current Dollars	(Line 3 x Line 5c)	134,457,575	135,586,137	136,684,699	137,783,261	138,881,823
7	Total Hospital Discharges-Including Nursery	Budget Statistics Page	14,216	14,216	14,216	14,216	14,216
8	TCU Discharges		435	435	435	435	435
9	Total Hospital and TCU Discharges	(Line 7 + Line 8)	14,651	14,651	14,651	14,651	14,651
10	Skilled Nursing Discharges	Sept 2002 Annualized	139	139	139	139	139
11	Total Discharges	(Line 9 + Line 10)	14,790	14,790	14,790	14,790	14,790
12	Current Month/Year Case Mix		1.3400	1.3400	1.3400	1.3400	1.3400
13	Gross Revenue Associated with Hospital IP Discharges	Budget Income Statement	154,294,110	154,294,110	154,294,110	154,294,110	154,294,110
14	Gross Revenue Associated with TCU Discharges		1,987,228	1,987,228	1,987,228	1,987,228	1,987,228
15	Total Gross Revenue Associated with Line 9 Discharges	(Line 13 + Line 14)	156,281,338	156,281,338	156,281,338	156,281,338	156,281,338
16	SNF Charge Equalization	SNF Rev. x 88.53288% (per 2001 audit)	5,417,125	5,417,125	5,417,125	5,417,125	5,417,125
17	Case Mix Associated with Skilled Nursing Discharges	((Line 16/Line 10)/(Line 15/Line 9) x Line 12)	4.89575	4.89575	4.89575	4.89575	4.89575
18	Discharges, Case Mix Adjusted - Hospital & TCU	(Line 9 x Line 12)	19,632	19,632	19,632	19,632	19,632
19	Discharges, Case Mix Adjusted - Skilled Nursing	(Line 10 x Line 17)	681	681	681	681	681
20	Total Case Mix Adjusted Discharges	(Line 18 + Line 19)	20,313	20,313	20,313	20,313	20,313
21	Outpatient Revenue Adjustment:						
22	Other Operating Revenue	Budget Income Statement	3,868,000	3,868,000	3,868,000	3,868,000	3,868,000
23	Less Investment Earnings	Budget Income Statement	(358,123)	(358,123)	(358,123)	(358,123)	(358,123)
24	Outpatient Charge Equalization	Otpt Rev. x 11.91983112% (per 2001 audit)	6,660,895	6,660,895	6,660,895	6,660,895	6,660,895
25	Subtotal	(Line 22 + Line 23 + Line 24)	10,170,772	10,170,772	10,170,772	10,170,772	10,170,772
26	Total Gross Patient Revenue	Budget Income Statement	215,280,893	215,280,893	215,280,893	215,280,893	215,280,893
27	Gross Patient Revenue Plus Other Operating Revenue	(Line 25 + Line 26)	225,451,665	225,451,665	226,451,665	225,451,665	225,451,665
28	Less Gross Revenue Associated with Excluded Services:						
29	Cardiothoracic Surgery Practice	Account Budget	970,070	970,070	970,070	970,070	970,070
29a	Palliative Care Grant		1,800	1,800	1,800	1,800	1,800
29b	Regional Network Supply Contracts		20,455	20,455	20,455	20,455	20,455
29c	Regional Network Mgmt Contract - TMC		101,342	101,342	101,342	101,342	101,342
29d	Simply Sterling		150,596	150,596	150,596	150,596	150,596
29e	Anesthesia Professional Services		1,101,128	1,101,128	1,101,128	1,101,128	1,101,128
30	Spectrum-not included in Other Operating Revenue						
31	Regional Network Grant	Account Budget					
32	Adjusted Gross Patient Revenue Plus Other Operating Rev.	(Line 27 - Line 29 thru Line 31)	226,096,274	226,096,274	226,096,274	226,096,274	226,096,274
33	Gross Inpatient Revenue	Budget Income Statement	152,400,110	152,400,110	162,400,110	152,400,110	162,400,110
34	Outpatient Adjustment Factor	(Line 32/Line 33)	1.392217	1.392217	1.392217	1.392217	1.392217
35	Current Year Adjusted Discharges, Case Mix Adjusted	(Line 34 x Line 20)	28,280.10	28,280.10	28,280.10	28,280.10	28,280.10
36	Base Year Adjusted Discharges, Case Mix Adjusted	(Worksheet 2, Line 24)	25,540.41	25,540.41	25,540.41	25,540.41	25,540.41
37	Ratio of Adjusted Discharges, Case Mix Adjusted	(Line 35/Line 36)	1.1030	1.1030	1.1030	1.1030	1.1030
38	Allowable Total Costs in Current Dollars	(Line 6)	134,457,575	135,586,137	136,684,699	137,783,261	138,881,823
39	1-Ratio of Case Mix Adjusted Discharges	(1 - Line 37)	(0.1030)	(0.1030)	(0.1030)	(0.1030)	(0.1030)
40	Variable Cost Approximation	(Line 38 x Line 39)	(13,852,220)	(13,965,372)	(14,078,524)	(14,191,676)	(14,304,828)
41	Fixed Cost Multiplier	(Worksheet 5, Line 7)	30%	30%	30%	30%	30%
42	Fixed Cost Correction	(Line 40 x Line 41)	(4,155,666)	(4,189,612)	(4,223,557)	(4,257,503)	(4,291,448)
43	Total Cost Target in Current Dollars	(Line 38 - Line 40 + Line 42)	144,184,129	145,361,897	146,539,666	147,717,434	148,895,203
44	Net Margin Target	(Worksheet 6, Line 2)	6%	6%	6%	6%	6%
45	Total Revenue Cap in Current Dollars	(Line 43/(1 - Line 44))	153,387,372	154,640,316	155,893,262	157,146,206	158,399,152
46	Net Patient Revenue-Hospital & BSNC	Budget Income Statement	156,783,024	156,783,024	156,783,024	156,783,024	156,783,024
47	Other Operating Revenue	(Line 22)	3,868,000	3,868,000	3,868,000	3,868,000	3,868,000
48	Nonoperating - Joint Venture OPS	Budget Income Statement	910,000				
48a	Nonoperating - Income from Limited Assets	Budget Income Statement	1,280,000				
48b	Nonoperating - Other Revenue/(Expenses)	Budget Income Statement	21,720				
48c	Duplicated Operating Interest						
49	Total Hospital Revenue	(Line 46 thru Line 48c)	162,862,744	160,651,024	160,651,024	160,651,024	160,651,024
50	Less Bad Debts	Budget Income Statement	6,984,131	6,984,131	6,984,131	6,984,131	6,984,131
51	Less Revenue from Excluded Services:						
52	Cardiothoracic Surgery Practice (Net based on YTD Oct 2002)	(Line 29 x 53.1%)	515,107	515,107	515,107	515,107	515,107
52a	Palliative Care Grant		1,800	1,800	1,800	1,800	1,800
52b	Regional Network Supply Contracts		20,455	20,455	20,455	20,455	20,455
52c	Regional Network Mgmt Contract - TMC		101,342	101,342	101,342	101,342	101,342
52d	Simply Sterling		150,596	150,596	150,596	150,596	150,596
52e	Anesthesia Professional Services		1,101,128	1,101,128	1,101,128	1,101,128	1,101,128
53	Spectrum/ASC Centers of Excellence						
53a	Employee Health Trust Plan						
54	Regional Network Grant	(Line 31)					
55	Less Unrealized Gains/Losses on Investments						
56	Adjusted Hospital Revenue	(Line 49 - Lines 50 thru 55)	153,978,185	151,766,465	151,766,465	151,766,465	151,766,465
58	Current Year Revenue Over (Under) the Cap	(Line 56 - Line 45)	590,813	(2,873,851)	(4,126,797)	(5,379,741)	(6,632,687)
59	Total Year 2003 Surplus		590,813	(2,873,851)	(4,126,797)	(5,379,741)	(6,632,687)
				31.02%	31.02%	31.02%	31.02%
	Contractual Revenue Split - 68.98%						
	Medicare/Medicaid/Other to Total			9,264,511	13,303,666	17,342,815	21,381,970
	Additional Gross Revenue for Price Increase	68.98%		5,390,659	9,176,869	11,963,074	14,749,283
	Contractuals			2,873,851	4,126,797	5,379,741	6,632,687
	Additional Net Patient Revenue						
	Gross Patient Revenue Budget 2002		215,280,893				
	Additional Gross Patient Revenue			9,264,511	4,039,155	4,039,149	4,039,155
	Total Gross Patient Revenue			227,545,404	231,584,559	235,623,708	239,662,863
	% Increase/(Decrease)			4.2%	1.8%	1.7%	1.7%

Attachment I

BENEFIS HEALTHCARE
COPA Model Analysis
Year 2001

		Actual 2001	Modified 2001	Modified Year - X	Modified Year - Y	Modified Year - Z
1 Baseline Total Costs	(Worksheet 1, Line 34)	116,026,775	116,026,775	116,026,775	116,026,775	116,026,775
2 Expected Cost Reduction	(Worksheet 12-Year 2003)	5,999,390	5,999,390	5,999,390	5,999,390	5,999,390
3 Allowable Costs in 1995 Dollars	(Line 1 - Line 2)	110,027,385	110,027,385	110,027,385	110,027,385	110,027,385
4 Market Basket Index Est. Current Year-2001	HCFA	130.7000000	130.7000000	130.7000000	130.7000000	130.7000000
5 Market Basket Index Base Year-1995	(Worksheet 3, Line 4)	109.85	109.85	109.85	109.85	109.85
5a Multiplier	(Line 4/Line5)	1.19	1.19	1.19	1.19	1.19
5b Add-On			0.010	0.020	0.030	0.040
5c Revised Multiplier	(Line 5a + Line 5b)	1.19	1.20	1.21	1.22	1.23
6 Allowable Total Costs in Current Dollars	(Line 3 x Line 5c)	130,932,588	132,011,327	133,111,601	134,211,875	135,312,149
7 Total Hospital Discharges-Including Nursery	Budget Statistics Page	13,983	13,983	13,983	13,983	13,983
8 TCU Discharges		434	434	434	434	434
9 Total Hospital and TCU Discharges	(Line 7 + Line 8)	14,417	14,417	14,417	14,417	14,417
10 Skilled Nursing Discharges	Sept 2002 Annualized	153	153	153	153	153
11 Total Discharges	(Line 9 + Line 10)	14,570	14,570	14,570	14,570	14,570
12 Current Month/Year Case Mix		1.3368	1.3368	1.3368	1.3368	1.3368
13 Gross Revenue Associated with Hospital IP Discharges	Budget Income Statement	138,114,165	138,114,165	138,114,165	138,114,165	138,114,165
14 Gross Revenue Associated with TCU Discharges		2,281,229	2,281,229	2,281,229	2,281,229	2,281,229
15 Total Gross Revenue Associated with Line 9 Discharges	(Line 13 + Line 14)	140,395,394	140,395,394	140,395,394	140,395,394	140,395,394
16 SNF Charge Equalization	SNF Rev. x 88.53288% (per 2001 audit)	5,272,897	5,272,897	5,272,897	5,272,897	5,272,897
17 Case Mix Associated with Skilled Nursing Discharges	((Line 16/Line 10)/(Line 15/Line 9) x Line 12)	4.73096	4.73096	4.73096	4.73096	4.73096
18 Discharges, Case Mix Adjusted - Hospital & TCU	(Line 9 x Line 12)	19,273	19,273	19,273	19,273	19,273
19 Discharges, Case Mix Adjusted - Skilled Nursing	(Line 10 x Line 17)	724	724	724	724	724
20 Total Case Mix Adjusted Discharges	(Line 18 + Line 19)	19,997	19,997	19,997	19,997	19,997
21 Outpatient Revenue Adjustment:						
22 Other Operating Revenue	Budget Income Statement	6,713,906	6,713,906	6,713,906	6,713,906	6,713,906
23 Less Investment Earnings	Budget Income Statement	(826,603)	(826,603)	(826,603)	(826,603)	(826,603)
24 Outpatient Charge Equalization	Otpt Rev. x 11.91983312% (per 2001 audit)					
25 Subtotal	(Line 22 + Line 23 + Line 24)	5,887,303	5,887,303	5,887,303	5,887,303	5,887,303
26 Total Gross Patient Revenue	Budget Income Statement	205,503,527	205,503,527	205,503,527	205,503,527	205,503,527
27 Gross Patient Revenue Plus Other Operating Revenue	(Line 25 + Line 26)	211,390,830	211,390,830	211,390,830	211,390,830	211,390,830
28 Less Gross Revenue Associated with Excluded Services:						
29 Foundation		311,966	311,966	311,966	311,966	311,966
29a Spectrum		5,900,976	5,900,976	5,900,976	5,900,976	5,900,976
29b Compwise		30,020	30,020	30,020	30,020	30,020
29c Employee Health Trust		596,969	596,969	596,969	596,969	596,969
29d HDI/Teamworks		9,474	9,474	9,474	9,474	9,474
29e Regional Network Supply Contracts		338,242	338,242	338,242	338,242	338,242
29f Regional Network Mgmt Contract - TMC		119,192	119,192	119,192	119,192	119,192
29g Palliative Care Grant		47,131	47,131	47,131	47,131	47,131
29h Simply Sterling		208,000	208,000	208,000	208,000	208,000
29i E.L. Wiegand Grant		168,300	168,300	168,300	168,300	168,300
30 Cardiothoracic Surgery Practice		313,698	313,698	313,698	313,698	313,698
31 Regional Network Grant	Account Budget					
32 Adjusted Gross Patient Revenue Plus Other Operating Rev.	(Line 27 - Line 29 thru Line 31)	203,346,862	203,346,862	203,346,862	203,346,862	203,346,862
33 Gross Inpatient Revenue	Budget Income Statement	141,950,024	141,950,024	141,950,024	141,950,024	141,950,024
34 Outpatient Adjustment Factor	(Line 32/Line 33)	1.434638	1.434638	1.434638	1.434638	1.434638
35 Current Year Adjusted Discharges, Case Mix Adjusted	(Line 34 x Line 20)	28,687.92	28,688.46	28,688.46	28,688.46	28,688.46
36 Base Year Adjusted Discharges, Case Mix Adjusted	(Worksheet 2, Line 24)	25,640.41	25,640.41	25,640.41	25,640.41	25,640.41
37 Ratio of Adjusted Discharges, Case Mix Adjusted	(Line 35/Line 36)	1.1189	1.1189	1.1189	1.1189	1.1189
38 Allowable Total Costs in Current Dollars	(Line 6)	130,932,588	132,011,327	133,111,601	134,211,875	135,312,149
39 1-Ratio of Case Mix Adjusted Discharges	(1 - Line 37)	(0.1189)	(0.1189)	(0.1189)	(0.1189)	(0.1189)
40 Variable Cost Approximation	(Line 38 x Line 39)	(15,567,885)	(15,696,147)	(15,826,969)	(15,957,792)	(16,088,614)
41 Fixed Cost Multiplier	(Worksheet 5, Line 7)	30%	30%	30%	30%	30%
42 Fixed Cost Correction	(Line 40 x Line 41)	(4,670,366)	(4,708,844)	(4,748,091)	(4,787,338)	(4,826,584)
43 Total Cost Target in Current Dollars	(Line 38 - Line 40 + Line 42)	141,830,107	142,998,630	144,190,479	145,382,329	146,574,179
44 Net Margin Target	(Worksheet 6, Line 2)	6%	6%	6%	6%	6%
45 Total Revenue Cap in Current Dollars	(Line 43/(1 - Line 44))	150,883,093	152,126,202	153,394,127	154,662,052	155,929,977
46 Net Patient Revenue-Hospital & BSNC	Budget Income Statement	154,153,328	154,153,328	154,153,328	154,153,328	154,153,328
47 Other Operating Revenue	(Line 22)	6,713,906	6,713,906	6,713,906	6,713,906	6,713,906
48 Nonoperating - Joint Venture OPS	Budget Income Statement					
48a Nonoperating - Income from Limited Assets	Budget Income Statement	2,697,409				
48b Nonoperating - Other Revenue/(Expenses)	Budget Income Statement					
48c Duplicated Operating Interest						
49 Total Hospital Revenue	(Line 46 thru Line 48c)	163,564,643	160,867,234	160,867,234	160,867,234	160,867,234
50 Less Bad Debts	Budget Income Statement	5,004,521	5,004,521	5,004,521	5,004,521	5,004,521
51 Less Revenue from Excluded Services:						
52 Foundation		422,962	422,962	422,962	422,962	422,962
52a Spectrum		5,928,924	5,928,924	5,928,924	5,928,924	5,928,924
52b Compwise		30,020	30,020	30,020	30,020	30,020
52c Employee Health Trust		620,355	620,355	620,355	620,355	620,355
52d HDI/Teamworks		9,474	9,474	9,474	9,474	9,474
52e Regional Network Supply Contracts		38,242	38,242	38,242	38,242	38,242
52f Regional Network Mgmt Contract - TMC		119,192	119,192	119,192	119,192	119,192
52g Palliative Care Grant		47,131	47,131	47,131	47,131	47,131
52h Simply Sterling		208,000	208,000	208,000	208,000	208,000
52i E.L. Wiegand Grant		168,300	168,300	168,300	168,300	168,300
53 Cardiothoracic Surgery Practice		269,161	269,161	269,161	269,161	269,161
53a Great Falls Athletic Club		18,031	18,031	18,031	18,031	18,031
54 Regional Network Grant	(Line 31)					
55 Less Unrealized Gains/Losses on Investments						
56 Adjusted Hospital Revenue	(Line 49 - Lines 50 thru 55)	150,680,330	147,982,921	147,982,921	147,982,921	147,982,921
58 Current Year Revenue Over (Under) the Cap	(Line 56 - Line 45)	(202,763)	(4,143,281)	(5,411,206)	(6,679,131)	(7,947,056)
59 Total Year 2003 Surplus		(202,763)	(4,143,281)	(5,411,206)	(6,679,131)	(7,947,056)
Contractual Revenue Split - 68.98%			31.02%	31.02%	31.02%	31.02%
Medicare/Medicaid/Other to Total			13,356,805	17,444,249	21,531,692	25,619,136
Additional Gross Revenue for Price Increase	68.98%		9,213,524	12,033,043	14,852,561	17,672,080
Contractuals			4,143,281	5,411,206	6,679,131	7,947,056
Additional Net Patient Revenue						
		205,503,527				
Gross Patient Revenue Budget 2002			13,356,805	4,087,444	4,087,444	4,087,444
Additional Gross Patient Revenue			218,860,332	222,947,776	227,035,219	231,122,663
Total Gross Patient Revenue			6.5%	1.9%	1.8%	1.8%
% Increase/(Decrease)						

Attachment I

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BENEFIS HEALTHCARE
COPA Model Analysis
Year 2000

			Actual 2000	Modified 2000	Modified Year - X	Modified Year - Y	Modified Year - Z
1 Baseline Total Costs	(Worksheet 1, Line 34)		116,026,775	116,026,775	116,026,775	116,026,775	116,026,775
2 Expected Cost Reduction	(Worksheet 12-Year 2003)		5,803,447	5,803,447	5,803,447	5,803,447	5,803,447
3 Allowable Costs in 1995 Dollars	(Line 1 - Line 2)		110,223,328	110,223,328	110,223,328	110,223,328	110,223,328
4 Market Basket Index Est. Current Year-2001	HCFA		125.7500000	125.7500000	125.7500000	125.7500000	125.7500000
5 Market Basket Index Base Year-1995	(Worksheet 3, Line 4)		109.85	109.85	109.85	109.85	109.85
5a Multiplier	(Line 4/Line5)		1.14	1.14	1.14	1.14	1.14
5b Add-On				0.010	0.020	0.030	0.040
5c Revised Multiplier	(Line 5a + Line 5b)		1.14	1.15	1.16	1.17	1.18
6 Allowable Total Costs in Current Dollars	(Line 3 x Line 5c)		126,205,711	127,279,598	128,381,831	129,484,064	130,586,298
7 Total Hospital Discharges-Including Nursery	Budget Statistics Page		13,601	13,601	13,601	13,601	13,601
8 TCU Discharges			376	376	376	376	376
9 Total Hospital and TCU Discharges	(Line 7 + Line 8)		13,977	13,977	13,977	13,977	13,977
10 Skilled Nursing Discharges	Sept 2002 Annualized		129	129	129	129	129
11 Total Discharges	(Line 9 + Line 10)		14,106	14,106	14,106	14,106	14,106
12 Current Month/Year Case Mix			1.3250	1.3250	1.3250	1.3250	1.3250
13 Gross Revenue Associated with Hospital IP Discharges	Budget Income Statement		126,291,925	126,291,925	126,291,925	126,291,925	126,291,925
14 Gross Revenue Associated with TCU Discharges			1,847,780	1,847,780	1,847,780	1,847,780	1,847,780
15 Total Gross Revenue Associated with Line 9 Discharges	(Line 13 + Line 14)		128,139,705	128,139,705	128,139,705	128,139,705	128,139,705
16 SNF Charge Equalization	SNF Rev. x 88.53288% (per 2001 audit)		5,719,837	5,719,837	5,719,837	5,719,837	5,719,837
17 Case Mix Associated with Skilled Nursing Discharges	((Line 16/Line 10)/(Line 15/Line 9) x Line 12)		5.49756	5.49756	5.49756	5.49756	5.49756
18 Discharges, Case Mix Adjusted - Hospital & TCU	(Line 9 x Line 12)		18,519	18,520	18,520	18,520	18,520
19 Discharges, Case Mix Adjusted - Skilled Nursing	(Line 10 x Line 17)		709	709	709	709	709
20 Total Case Mix Adjusted Discharges	(Line 18 + Line 19)		19,228	19,229	19,229	19,229	19,229
21 Outpatient Revenue Adjustment:							
22 Other Operating Revenue	Budget Income Statement		8,106,823	8,106,823	8,106,823	8,106,823	8,106,823
23 Less Investment Earnings	Budget Income Statement						
24 Outpatient Charge Equalization	Otpt Rev. x 11.9198312% (per 2001 audit)						
25 Subtotal	(Line 22 + Line 23 + Line 24)		8,106,823	8,106,823	8,106,823	8,106,823	8,106,823
26 Total Gross Patient Revenue	Budget Income Statement		183,469,455	183,469,455	183,469,455	183,469,455	183,469,455
27 Gross Patient Revenue Plus Other Operating Revenue	(Line 25 + Line 26)		191,576,278	191,576,278	191,576,278	191,576,278	191,576,278
28 Less Gross Revenue Associated with Excluded Services:							
29 Foundation	Account Budget		455,159	455,159	455,159	455,159	455,159
29a Spectrum			3,525,424	3,525,424	3,525,424	3,525,424	3,525,424
29b Compwise			49,580	49,580	49,580	49,580	49,580
29c Employee Health Trust			429,459	429,459	429,459	429,459	429,459
30 Spectrum-not included in Other Operating Revenue							
31 Regional Network Grant	Account Budget						
32 Adjusted Gross Patient Revenue Plus Other Operating Rev.	(Line 27 - Line 29 thru Line 31)		187,116,656	187,116,656	187,116,656	187,116,656	187,116,656
33 Gross Inpatient Revenue	Budget Income Statement		133,859,542	133,859,542	133,859,542	133,859,542	133,859,542
34 Outpatient Adjustment Factor	(Line 32/Line 33)		1.437050	1.437050	1.437050	1.437050	1.437050
35 Current Year Adjusted Discharges, Case Mix Adjusted	(Line 34 x Line 20)		27,632.23	27,633.03	27,633.03	27,633.03	27,633.03
36 Base Year Adjusted Discharges, Case Mix Adjusted	(Worksheet 2, Line 24)		25,640.41	25,640.41	25,640.41	25,640.41	25,640.41
37 Ratio of Adjusted Discharges, Case Mix Adjusted	(Line 35/Line 36)		1.0777	1.0777	1.0777	1.0777	1.0777
38 Allowable Total Costs in Current Dollars	(Line 6)		126,205,711	127,279,598	128,381,831	129,484,064	130,586,298
39 1-Ratio of Case Mix Adjusted Discharges	(1 - Line 37)		(0.0777)	(0.0777)	(0.0777)	(0.0777)	(0.0777)
40 Variable Cost Approximation	(Line 38 x Line 39)		(9,803,509)	(9,889,625)	(9,975,268)	(10,060,912)	(10,146,555)
41 Fixed Cost Multiplier	(Worksheet 5, Line 7)		30%	30%	30%	30%	30%
42 Fixed Cost Correction	(Line 40 x Line 41)		(2,941,053)	(2,966,888)	(2,992,580)	(3,018,274)	(3,043,967)
43 Total Cost Target in Current Dollars	(Line 38 - Line 40 + Line 42)		133,068,167	134,202,335	135,364,519	136,526,702	137,688,886
44 Net Margin Target	(Worksheet 6, Line 2)		6%	6%	6%	6%	6%
45 Total Revenue Cap in Current Dollars	(Line 43/(1 - Line 44))		141,561,879	142,768,441	144,004,808	145,241,173	146,477,538
46 Net Patient Revenue-Hospital & BSNC	Budget Income Statement		138,860,958	138,860,958	138,860,958	138,860,958	138,860,958
47 Other Operating Revenue	(Line 22)		8,106,823	8,106,823	8,106,823	8,106,823	8,106,823
48 Nonoperating - Joint Venture OPS	Budget Income Statement						
48a Nonoperating - Income from Limited Assets	Budget Income Statement		2,943,858				
48b Nonoperating - Other Revenue/(Expenses)	Budget Income Statement						
48c Duplicated Operating Interest							
49 Total Hospital Revenue	(Line 46 thru Line 48c)		149,911,639	146,967,781	146,967,781	146,967,781	146,967,781
50 Less Bad Debts	Budget Income Statement		4,354,898	4,354,898	4,354,898	4,354,898	4,354,898
51 Less Revenue from Excluded Services:							
52 Foundation			455,159	455,159	455,159	455,159	455,159
52a Spectrum			3,537,774	3,537,774	3,537,774	3,537,774	3,537,774
52b Compwise			49,580	49,580	49,580	49,580	49,580
52c Employee Health Trust			429,459	429,459	429,459	429,459	429,459
52c Simply Sterling							
52e Anesthesia Professional Services							
53 Spectrum/ASC/Centers of Excellence							
53a Employee Health Trust Plan							
54 Regional Network Grant	(Line 31)						
55 Less Unrealized Gains/Losses on Investments							
56 Adjusted Hospital Revenue	(Line 49 - Lines 50 thru 55)		141,084,769	138,140,911	138,140,911	138,140,911	138,140,911
58 Current Year Revenue Over (Under) the Cap	(Line 56 - Line 45)		(477,110)	(4,627,530)	(5,863,897)	(7,100,262)	(8,336,627)
59 Total Year 2003 Surplus			(477,110)	(4,627,530)	(5,863,897)	(7,100,262)	(8,336,627)
Contractual Revenue Split - 68.98%				31.02%	31.02%	31.02%	31.02%
Medicare/Medicaid/Other to Total				14,917,892	18,903,601	22,889,304	26,875,006
Additional Gross Revenue for Price Increase		68.98%		10,290,362	13,039,704	15,789,042	18,538,379
Contractuals				4,627,530	5,863,897	7,100,262	8,336,627
Additional Net Patient Revenue							
			183,469,455				
Gross Patient Revenue Budget 2002				14,917,892	3,985,709	3,985,703	3,985,703
Additional Gross Patient Revenue				198,387,347	202,373,056	206,358,759	210,344,461
Total Gross Patient Revenue				8.1%	2.0%	2.0%	1.9%
% Increase/(Decrease)							

Attachment I

COPA MODEL ANALYSIS – RECAP OF MODIFICATIONS IMPACT

Base is Projected 2002	**Modified 2002**	**2003**	**2004**	**2005**
Inflation increase (+1%)	$1,252,944	$2,505,890	$3,758,834	$5,011,780
Excluding non-operating margin	$2,211,720	$2,211,720	$2,211,720	$2,211,720
Total	**$3,464,664***	**$4,717,610**	**$5,970,554**	**$7,223,500**
Impact on operating margin	+2.2%	+2.2%	+2.2%	+2.2%
Estimated impact on price increase (gross revenue)	+4.2%	+1.8%	+1.7%	+1.7%

Base is Actual 2001	**Modified 2002**	**2003**	**2004**	**2005**
Inflation increase (+1%)	$1,243,109	$2,511,034		
Excluding non-operating margin	$2,697,409	$2,697,409	$2,697,409	$2,697,409
Total	$3,940,518	$5,208,443	$6,476,368	$7,744,293
Impact on operating margin	+2.6%	+2.6%	+2.6%	+2.6%
Estimated impact on price increase (gross revenue)	+6.2%	+1.9%	+1.8%	+1.8T

Base is Actual 2000	**Modified 2002**	**2003**	**2004**	**2005**
Inflation increase (+1%)	$1,206,562	$2,442,929	$3,679,294	$4,915,659
Excluding non-operating margin	$2,943,858	$2,943,858	$2,943,858	$2,943,858
Total	$4,150,420	$5,386,787	$6,623,152	$7,859,57
Impact on operating margin	+2.9%	+2.9%	+2.9%	+2.9%
Estimated impact on price increase (gross revenue)	+8.1%	+2.0%	+2.0%	+1.9%

*Because the modifications to FY 2002 will be obtained at the end of the year, it will not be possible to increase prices during the year to realize the full financial improvement. This year's net revenues will exceed the amount allowed under the COPA by approximately $2 million, however. Consequently, if the COPA is modified as proposed, the benefit Benefis will actually realize in 2002 will be this amount of $2 million, rather than the amount shown for 2002 of $3,464,664.

Attachment J

REQUESTED CHANGES TO THE COPA – NON-REVENUE CAP ITEMS

Annual Reporting (1.5)

The current annual report consists of information required from various subsections within the COPA Agreement. Several components of the annual report were geared specifically to monitor and measure progress on the merger process itself. Since the merger occurred six years ago, and all related merger activity has been completed, Benefis requests eliminating reporting such matters.

- (1.5-2) Eliminate the requirement to summarize the steps taken to reduce costs and improve efficiency.

  The purpose for this reporting element was to ensure that Benefis pursued and achieved the cost reductions and efficiencies promised as part of the merger agreement. All of these required cost reductions have been achieved. Thus this reporting requirement is essentially completed.

- (1.5-3) Eliminate the requirement to report changes in full time equivalent staff.

  Like item 1.5-2, this requirement primarily was concerned with the reduction in numbers of staff as a consequence of the merger process. The intent was to ensure that staff reductions (and thereby costs) were achieved, while at the same time ensuring that reductions were not excessive, thus affecting quality of care. Benefis has completed the merging process and the associated "shake out" of staffing requirements, thus this reporting element is completed.

- (1.5-4) Eliminate the requirement calling for a description of services/functions consolidated.

  As with the previous two annual report requirements, this item deals with reporting on the merger process. Now that the merger process is complete, this reporting requirement is obsolete as well.

- (2.3 and 2.12) Modify the quality reporting and interaction between Benefis, the Department of Justice and the Department of Public Health and Human Services.

  Benefis does not wish to alter the three-way reporting relationship; however the hospital does wish to modify the quality reporting from a quarterly basis to an annual basis. (The COPA agreement itself does not require quarterly reporting.) Benefis also requests that the report be revamped in collaboration with the Department of PHHS. Benefis proposes the following change to section 2.12; "continue to collect and report the data for all quality indicators selected by PHHS, in a year-end annual report, and in accordance with the interagency agreement referred to in section 2.1. A summary of the quality data is to be included in each annual report submitted under Mont. Admin. R. 23.18.106, in a form approved by PHHS. The form and reporting

content may by changed by mutual agreement between Benefis and the Department of PHHS as industry measures and clinical trends change over time."

Currently some of the originally defined reporting elements are simply not available, and others have marginal value in terms of effectively measuring quality. Benefis understands that the reporting elements may be changed at any time simply as a function of conversation and agreement between Benefis and the Department of PHHS, subject to approval by the Department of Justice. Accordingly, changes to the items contained in the quality report should not actually represent a change to the COPA Agreement. In like manner, the COPA Agreement does not state the reporting frequency for the quality reports. The convention of a quarterly reporting was established by the Department of PHHS based primarily on concern that waiting an entire year to assess quality would not be prudent in the early years of the merger. Now that Benefis has passed the six-year point post-merger, coupled with the fact that the hospital has not had any significant quality issues during this six-year period of time, we believe it is appropriate to adjust the quality reporting to an annual basis. Even though Benefis believes the proposed changes do not require a change to the current COPA Agreement, we are proposing these changes to clarify the requirement.

Surveys (2.15)

Currently, annual surveys of the medical staff and employees are required. Benefis requests a change in the survey frequency to modify the language addressing medical staff and employee surveys to read as follows: "Conduct periodic surveys of the hospital's medical staff and employees, with such surveys occurring at least once every three years. A summary of the survey results are to be included in the annual report." This proposed language also would allow Benefis the discretion to select the survey tool.

Benefis is committed to continuing surveys of our medical staff and employees. The hospital believes an annual survey is too frequent and actually counterproductive. Consulting firms that administer such surveys recommend that the surveys be taken only every few years. This allows sufficient time for the hospital to properly assess the results of the survey, develop appropriate action plans, communicate results and action plans to physicians/employees, and have adequate time to carryout actions plans including making results visible and available to physicians/employees (thus demonstrating that the survey information is, in fact, used and responded to by hospital administration). Annual surveys do not provide sufficient time for this cycle to be completed and cause physicians/employees to perceive that surveys are not responded to by the hospital administration, thus causing negative attitudes and relationships. Eliminating the requirement that the survey tool be approved by the Department of PHHS, would allow Benefis the flexibility to select an appropriate tool and utilize the same survey tools used by other Providence Services hospitals, thus providing a comparative benchmark and picture of all Providence Services hospitals that is consistent. Finally, by contracting for such services through the Providence Services system, Benefis will achieve financial savings.

Non-exclusivity

Currently, the COPA provides that Benefis shall not restrict independent physicians from providing services outside Benefis or from participating in competing physician/hospital networks (5.3 and 5.4). Section 5.5 precludes Benefis from having exclusive contracts limiting privileges to a specified physician or a group of physicians except for Radiology, Pathology, Emergency Room, and Radiation Oncology.

The current COPA language recognizes that it may be necessary and desirable for Benefis to enter into exclusive contracts for certain types of physician services in order to assure its patients that the availability and quality of care will meet the needs and expectations of Benefis and the communities we serve. Currently, the language addresses four specific types of hospital-based physicians. There are hospital-based physician specialties that are not covered, however. Benefis requests that section 5.3 be modified to read as follows: "Except for hospital-based physicians, Consolidated Hospital shall not restrict an independent physician's ability to provide services or procedures outside of the Consolidated Hospital, unless performance of duties outside the Consolidated Hospital would impair or interfere with the safe and effective treatment of patients at the Consolidated Hospital." In like manner, Benefis requests a modification to section 5.4 to read as follows: "Except for hospital-based physicians, Consolidated Hospital shall not prohibit independent physicians who are members in any Consolidated Hospital physician-hospital network from participating in any other physician-hospital networks, health plans, or integrated delivery systems." Benefis also requests that section 5.5 be modified to allow exclusivity on all hospital-based physicians.

As implied in the term, "hospital-based," the services rendered by these physicians are integral to the overall operation and success of the hospital, not unlike the hospital's dependence on its employees. Benefis must be able to assure its patients and the community that full time (and, where necessary, 24-hour, seven day a week) coverage is available at the hospital in these important specialties. In order for Benefis to ensure the services of these hospital-based physicians are available consistently, including around the clock when necessary, and that these services are of the quality the community expects, Benefis seeks to be able to expand exclusive contracts to all hospital-based physician specialties.

The exclusivity Benefis seeks would apply in both directions, *i.e.*, hospital-based physicians my receive exclusive privileges for certain services at Benefis and, as appropriate, Benefis may contractually restrict these physicians as to where they can provide their services and in which networks they may participate.

Agreements with Surgical Facility Providers

Benefis cannot offer or accept an equity type partnering on surgical services/facilities (8.1)

Benefis requests elimination of this COPA section to establish a "level playing field" such that Benefis has the same freedoms and opportunities as its competitors to develop relationships and alliances as appropriate to further its mission. Two competitors both have determined that it is advantageous to enter into equity type relationships with physicians. The original intent of this

COPA restriction was to preclude Benefis from taking advantage of its position as the sole hospital in Great Falls to maintain a monopoly in surgical services. The market has changed substantially since 1996, however, and this COPA restriction now has become an impediment to Benefis being able to assess the full range of options for structuring its delivery of surgery services in the manner that it believes best furthers its charitable mission. Many sections within the COPA provide security and freedom to physicians such that their credentialing and privileges cannot be linked to their decision regarding participation in Benefis sponsored initiatives. Given this, no physician will feel pressured to participate in any venture with Benefis.